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STATE FOR EAP/CM
TREASURY FOR OASIA/INA -- DOHNER/HAARSAGER/WINSHIP
TREASURY FOR IMFP -- SOBEL/CUSHMAN
USDOC FOR ITA DAS KASOFF, MELCHER, MAC/OCEA
NSC FOR LOI, SHRIER
STATE PASS CEA FOR BLOCK
STATE PASS USTR FOR STRATFORD/WINTER/MCCARTIN/KATZ/MAIN
STATE PASS CFTC FOR OIA/GORLICK

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SUBJECT: EAST CHINA COMMODITY EXPORTS HEADING FOR RECOVERY? YIWU
ENTREPRENEURS, OFFICIALS SEE LIGHT AT END OF TUNNEL

REF: A) 08 SHANGHAI 467; B) SHANGHAI 21; C) 08 SHANGHAI 476

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¶1. (SBU) Summary: One of the largest manufacturing and trading
centers in East China, the city of Yiwu in Zhejiang Province
suffered in late 2008 from the global financial crisis but is
seeing signs of recovery. The economic downturn has impacted
different industries to varying degrees, with manufacturers of
daily necessities and seasonal products, like Christmas
decorations, faring better than manufacturers of interior
decorations, arts and crafts, and electronic appliances. Firms
are also adjusting their lines of products and markets, with
many focusing more on the Chinese domestic market and developing
regions of Latin America and the Middle East to compensate for
declining exports to the United States and Europe, though our
interlocutors are also starting to see a gradual recovery in
orders from developed markets. The H1N1 flu outbreak, which has
discouraged some overseas customers from visiting China, has had
a big impact on some Yiwu companies. The Yiwu local government
is hoping to receive fiscal stimulus funds from the Central
Government for local infrastructure projects. An IPR service
center in the Yiwu commodities trading market handles 3-5
complaints a day, mostly from domestic companies, and
coordinates investigations of IPR infringement with relevant
local government agencies. End summary.

¶2. (U) During a trip to Yiwu (Zhejiang Province) June 4-5,
Congenoff spoke with local government officials, managers of
trading companies, and executives of several local manufacturing
firms about the impact of the global economic crisis and China's
domestic economic downturn on Yiwu's manufacturers and exports.
(Note: For more on Yiwu, see Reftels. End note.)

All Impacted, But Not Equally

13. (SBU) Li Zhiqiang, Vice Director of the Yiwu Foreign Affairs Office (FAO), told Congenoff on June 5 that the global financial crisis caused a general downturn in Yiwu's economy, particularly in the latter half of 2008. GDP growth was 12 percent in 2008 compared with 15.7 percent in 2007, largely due to a sharp decline in exports from October to December 2008. Weng Jianping, Vice Director General of the Yiwu Foreign Trade and Economic Cooperation Bureau, said during a separate meeting on June 4 that all industries in Yiwu were impacted by the global crisis, but some more than others. Manufacturers of socks, clothing, and other "daily necessities" have done relatively well, while makers of electronic appliances and arts and crafts have suffered, according to Weng.

14. (SBU) Sun Yongquan, General Manager of The China Small Commodities City Group Foreign Trade Co, Yiwu's largest foreign trading company, told Congenoff on June 5 that he has actually seen a rise in exports of some "daily necessities," such as clothes and toothbrushes, while exports of home decorations, arts and crafts, and entertainment products have declined significantly. Sun's company, which "exports all products to most countries of the world," had experienced 15-20 percent annual growth the past few years until orders plummeted in late October 2008, said Sun. Some overseas markets were hit harder than others. Orders from the United States, Europe, South Korea, Russia, and Ukraine were down "a lot" in late 2008, while orders from Africa and the Middle East actually increased slightly in the same period, according to Sun.

Domestic Market Compensating for Slowing Exports

15. (SBU) Our interlocutors explained various ways in which they are adapting to the economic downturn. Lou Zhongping, President

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of Shuangtong Daily Necessities Co, the world's largest manufacturer of drinking straws, spoke of his company's increasing focus on the Chinese domestic market during a meeting on June 4. The global economic downturn has had minimal impact on his company, he said, as sales grew 13 percent year-on-year in 2008 and 19 percent in January-May 2009, and his factory of 500 workers continues to operate 24 hours a day. Most of this growth, however, has come from the domestic market, compensating for slowing growth overseas, said Lou. Exports accounted for 80 percent of total sales in 2002 but now account for only 40 percent, with the United States (Walmart, Target, Dollar Tree) and Europe the primary overseas markets. While the company shifts its focus increasingly to the domestic market, it is also developing higher-end products, such as environmentally-friendly biodegradable drinking straws made from corn, which are roughly twice as expensive as regular straws but have been well received in Europe and Japan. Lou also noted that his company imports 70 percent of the raw material (polypropylene) used to make straws because it is cheaper when imported in bulk, and for the last two years the Chinese Government has been encouraging firms to import raw materials to help balance China's trade surplus. (Note: Congenoff observed piles of bags marked as polypropylene from Colombia, South America in the factory warehouse. End note.) Lou attributed his company's continued growth to his belief that consumers will not cut back on the use of straws. "People will continue to drink Coke" even amid economic downturns, Lou said, and "most people prefer to drink Coke using straws."

Diversifying Products: Christmas Still Coming to Yiwu

16. (SBU) Some of our interlocutors explained how they are diversifying their product line and export markets to cope with the downturn. Huang Yiming, President of Yiwu Hangtian Arts & Crafts Co, one of Yiwu's largest manufacturers of Christmas decorations, told Congenoff on June 4 that the global financial crisis has had some impact on his business, but not as much as anticipated. Exports account for 60 percent of Hangtian's sales. Most orders in 2008 were placed before the financial crisis, alleviating some of the effects of the economic downturn in late 2008, but orders in early 2009 were down 20 percent from

the same period in 2008 as customers have focused on reducing inventory, said Huang. However, exports to Brazil, Mexico, Malaysia, Singapore, and the Philippines have been "good" so far this year and have blunted the impact of declining orders from the United States and Western Europe. Increasing domestic sales through large retailers such as Carrefour and Metro hypermarkets in China have also helped offset some of the decline in developed markets. The company is diversifying its product line, developing products for Valentine's Day and decorations for customers in the Middle East. Huang is also fairly optimistic about his company's main product line, Christmas decorations, since he believes people worldwide will continue to celebrate Christmas regardless of the economic situation. However, his company is now focusing more on basic low-end Christmas decorations, which are still selling well, since sales of fancy electronic Christmas decorations have declined, according to Huang.

17. (SBU) Shi Jianjun, General Manager of Topsees Co, a trading company and manufacturer of household decorations such as picture frames and wall decorations, told Congenoff on June 5 that all of his company's products are exported, mostly to the United States (50-60 percent of total exports) as well as to the EU, Middle East, Japan, and India. Revenue at Topsees has grown 30-40 percent annually over the past few years but slowed considerably in late 2008, with exports to the United States and EU growing only 10 percent in Q1 2009 compared with Q1 2008. Although growth has slowed, Shi said, his company's sales are still relatively stable, especially when compared with some of

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his competitors making household decorations. Topsees has fared better than others because it began diversifying its products and export markets in late 2007, shifting a significant portion of its product line to more high quality, high-end home decorations and also designing products specifically for customers in the Middle East. The company's bottom line is also helped by the fact that it has an in-house design unit that can produce custom-made products, unlike other companies that solely rely on mass produced low-end decorations. One of Topsees' biggest competitors, Huahong, has suffered through the economic downturn because of its high personnel costs and focus on mass production of generic products, said Shi. (Note: See Refs a and b for more on Huahong. End note.) Topsees does not plan to expand into the domestic market, as its products are designed for "foreign tastes" and are not suitable for typical Chinese homes, said Shi.

Fake Flowers Shriveling Under Economic Pressure

18. (SBU) Some Yiwu industries have suffered more than others, as explained to Congenoff during a meeting on June 4 by Gong Hangbin, President of Yiwu Hangbin Imitation Plants Production Co, the largest among "several thousand" artificial flower companies in Yiwu. Gong lamented that his company has been hard hit by the global economic downturn, as exports account for 90 percent of his company's sales. Revenue has declined 30 percent in Q1 2009 compared with the same period in 2008, said Gong. Prior to this year, the company had enjoyed 20 percent annual growth. The number of company employees has also declined to 300 from its peak of 700-800 in 2004. Gong said that, despite the downturn, his company will continue to focus on exports rather than the domestic market, as China does not have a large demand for artificial plants and flowers. Gong also explained that his company is still better off than many of his competitors in Yiwu because, as the largest manufacturer of these products, his company has a stable line of larger customers who place orders in bulk.

H1N1 Hurting Business in Short Term

19. (SBU) Several of our interlocutors said that the H1N1 flu outbreak has had a bigger impact on their businesses in the short term than the global financial crisis. Huang Yiming of Yiwu Hangtian Arts & Crafts Co said that Mexico is one of his company's largest export markets, and many of his Mexican

customers have postponed their travel to China in recent months due to H1N1. Wang Xia, Sales Manager of Topsees Co, also said several large customers from Mexico canceled their trips to China in May, and the company forecasts June to be a slow month due to continued concerns over H1N1. (Note: Chinese health authorities have reported fewer than 100 confirmed cases of H1N1 within China as of the time of this early June visit to Yiwu. China's strict inspection of airline passengers and quarantining even of passengers seated near suspected cases on inbound flights may be an important factor in deterring some foreign customers' travel to China. End note.)

Signs of Recovery

¶10. (SBU) Most of our interlocutors painted a cautiously optimistic picture for 2009. Li Zhiqiang of the Yiwu FAO said Yiwu's GDP grew by 6 percent in Q1 2009 on an annualized basis, and he expects 8-9 percent GDP growth for all of 2009. While lower than the 12 percent growth of 2008, Li sees the glass half full, saying that Yiwu has done better than other export-oriented cities like Dongguan (in Guangdong Province) because Yiwu has a more diverse array of industries, many of which produce "daily necessities" that can withstand sharp economic downturns. Sun Yongquan of the trading company said his company's sales were up 3.8 percent in Q1 2009, and he sees

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signs of recovery even in developed countries. Sales to the United States started to pick up again after January 2009, said Sun, as customers have reduced inventories and have started placing orders again. He thinks the US and EU economies have started to stabilize, leading to stabilization in other regions as well. Sun Yongquan and Shi Jianjun of Topsees expect their businesses to pick up in August or September 2009, with Shi forecasting 20 percent sales growth for 2009. Shi noted that customer traffic at the biannual Canton Fair in October 2008 was "not good," but customer orders at the April 2009 Canton Fair were actually higher than in April 2008.

Yiwu: Still Growing, Waiting for Fiscal Stimulus Money

¶11. (SBU) Our interlocutors said the Yiwu local government has been very supportive of local businesses, providing tax incentives and facilitating loans to small and medium-sized enterprises. The local government has also gone to great lengths to transform Yiwu, once a backwater agricultural city, into a cosmopolitan center of trade with a large population of foreign residents. (Note: For more on Yiwu's foreign resident population, see Refs b and c. End note.) The city is still growing, and Congenoff observed construction of new buildings throughout the city, including a new technical training college and a new stadium-sized trading center. Feng Meilan, Director of the Yiwu FAO, told Congenoff during a June 4 dinner that Yiwu expects to eventually receive some fiscal stimulus funds from the Central Government. The funds will be used primarily to build new roads and schools, particularly for children of Yiwu's migrant workers. (Note: There are more than 1 million migrant workers, compared with 700,000 native residents, in Yiwu. End note.) When asked if these projects would favor local construction firms, Feng replied that all projects would be subject to an open bidding process, and that most construction firms currently operating in Yiwu are Shanghai-based firms. Feng added that she does not know when the city would receive stimulus funds from the Central Government.

IPR Service Center

¶12. (SBU) Chen Xinhua, Director of the Yiwu Service Center for Intellectual Property Protection, told Congenoff on June 5 that the IPR Center was established in August 2006 and currently has 9 full-time staff. (Note: Congenoff observed 7 staff in the Center's offices during the visit. End note.) Located in one of Yiwu's large commodities trading markets, the Center is responsible for receiving all complaints of IPR-infringement involving products sold in the Yiwu commodities markets. According to Chen, the Center operates 24 hours a day and serves

as the initial point of contact for all IPR-related complaints. People with complaints usually call 110 (the police hotline) first and get their calls transferred to the Center since "most people do not know the Center's direct phone number," said Chen.

The Center handles 3-5 calls a day, mostly from domestic Chinese companies involving accusations of trademark infringement, commercial espionage, and illegal reproduction of company publications, said Chen. There have been very few complaints from US companies, according to Chen, though he recalled a case involving Johnson & Johnson a few years ago. Few calls have come from EU and Japanese companies. Although none of the staff in the Center speak foreign languages, most callers can speak Chinese. If the caller is a foreigner who does not speak Chinese, the Center engages in a three-way call with the foreigner and the Yiwu Public Security Bureau, which has staff with foreign language capability, explained Chen. The Center does not conduct any investigations itself. Instead, it coordinates investigations with relevant local government agencies, such as the Bureau of Industry and Commerce. Many of the products suspected of IPR infringement are not made in Yiwu, but only sold in the Yiwu markets, he said. Chen further

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explained that the Center hosts a monthly meeting with representatives from 19 local government agencies to discuss individual cases, and that the Yiwu Vice Mayor sometimes attends these meetings.

Comment

113. (SBU) Yiwu was impacted by the global financial crisis like all export-oriented cities in China, but has fared better than others because of the diversity of its industries and products, said most of our interlocutors. Our interlocutors also said the economic downturn in Yiwu was relatively short-lived, as they already see signs of gradual recovery. Anecdotal evidence, however, suggests a more nuanced reality, with many enterprises still facing dire prospects for the foreseeable future. A Saudi Arabian entrepreneur who travels to Yiwu 3-4 times a year to oversee his local factory, for example, said his exports of clothes and fashion accessories to Saudi Arabia have declined 50 percent in 2009. This same individual also noted that "Yiwu was doing better than Guangzhou," where he also has business, since Yiwu's products were lower cost than those available in the Pearl River Delta. There remains much uncertainty amid the cautious optimism of many of our interlocutors, as their expectations for recovery in 2009 largely hinges on their hope that the US economy, still the largest export destination for many of these firms, has bottomed out.
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